Title

Intersection of fraudulent conveyance doctrine and the law of trusts

Text

Intro. This posting is about a gratuitous entrustment by transfer that somehow unjustifiably disadvantages the settlor's creditors. The independent sole-trustee and trust beneficiaries neither knew nor should have known that the entrustment would have that effect. Settlor has reserved no beneficial interest and no powers. As between the creditors and the innocent beneficiaries, the former should prevail. The common law (as enhanced by equity) and statute each affords the creditors a possible path to restitution. Pleading in the alternative may be advisable.

Equity. This cannot be in equity's bailiwick. "Where the equities are equal the law shall prevail" goes the maxim. Lord Mansfield, however, introduced via *Moses v. Macferlan* (Eng. 1750) a critical exception to the maxim, namely unjust enrichment. Long before the Restatement of Restitution (U.S. 1936) and *Stone v. White* (U.S. Sup. Ct. 1937), unjust enrichment doctrine had been woven into the fabric of U.S. equity. Our innocent trust beneficiaries have been unjustly enriched and our innocent disadvantaged creditors are entitled to equitable restitution. The entrustment being gratuitous, neither trustee nor beneficiary qualifies as a BFP. The creditors will want the innocent express trustee to be judicially morphed into a constructive trustee now for their benefit. The creditors will have a reasonable period after having become aware of the unjust enrichment to bring suit for restitution. Ref. Equity's doctrine of laches. Whether the settlor intended to disadvantage his creditors is irrelevant. That there has been a consequential unjustifiable enrichment suffices.

Fraudulent conveyance/transfer statutes. The "precursor" to modern fraudulent transfer statutory jurisprudence is the "Statute of 13 Elizabeth" (1571). *See* David J. Slenn, *The Fraudulent Transfer of Wealth* 4 (ABA 2022). In the U.S. we have the Unif. Fraudulent Conveyance Act (1918), Unif. Fraudulent Transfer Act (1984), and Unif. Voidable Transactions Act (2014) or UVTA. Prior to 1918 fraudulent-conveyance legislation state to state was nonuniform. The UVTA declares a transfer made with actual intent to hinder, delay, or defraud creditors to be fraudulent. A transfer made without adequate consideration that disadvantages creditors is constructively fraudulent. Here the debtor's actual intent is irrelevant. In either case, the statute of limitations is 4 years from date of transfer. In the case of actual fraud, the creditors also have a year from when they discovered or reasonably should have discovered the fraud. UVTA's remedies are primarily equitable.

Practice tip. UVTA is exclusively fraud-based, whether actual or constructive, while unjust-enrichment jurisprudence is less restrictive. It will even remediate an innocent mistake where insolvency not an issue. Thus we have two relatively independent causes of action. That having been said, UVTA may possibly tweak equity's unjust enrichment jurisprudence in the fraudulent conveyance context by replacing laches' "unreasonable delay" time bar with a fixed 4 year/1 year time bar. *Cf.*, *e.g.*, *Donell v. Keppers*, 835 F. Supp. 2d 871, 878-79 (S.D. Cal. 2011). Conversely, in egregious situations laches may short-circuit UVTA's fixed time bar. See UVTA §12, cmt. In any case, the UVTA is about supplementing, not supplanting: "Unless displaced by the provisions of this [Act], the principles of law and equity, including the law merchant and the law relating to principal and agent, estoppel, laches, fraud, misrepresentation, duress, coercion, mistake, insolvency, or other validating or invalidating cause, supplement its provisions." UVTA §12. Though the two causes of action, one equitable the other statutory, are independent, disadvantaged creditors may not double dip: "He who seeks equity must do equity."

Cross ref. The fraudulent conveyance/transfer to an out-of-state trustee of a domestic asset protection trust (DAPT) is taken up in §9.28 of *Loring and Rounds: A Trustee's Handbook* (2023), the relevant portions of which section are set forth in the appendix below. The Handbook is available for purchase at https://law-store.wolterskluwer.com/s/product/loring-rounds-trustees-hanbook-2023e/01t4R00000Ojr97QAB.

Appendix

§9.28 The Domestic Asset Protection Trust (DAPT) [from *Loring and Rounds: A Trustee's Handbook* (2023), available for purchase at https://law-store.wolterskluwer.com/s/product/loring-rounds-trustees-hanbook-2023e/01t4R00000Ojr97QAB].

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The Constitution's Full Faith and Credit Clause: Its politics and policy. Justice Jackson once referred to the Full Faith and Credit Clause as the "Lawyer's Clause" of the Constitution. "And so it is, for its concern is with litigation, and it is unlikely that many members of the general public have heard of it. After all, what are they likely to know of choice of law or preclusive effect? Yet the Framers thought it important enough to include in the wonderfully concise document they drafted in 1787."[45]

Again, Article IV, Section 1 of the U.S. Constitution, which deals with relations between and among the states, provides as follows: "Full faith and credit shall be given in each State to the public acts, Records, and judicial Proceedings of every other State. And the Congress may by general Laws prescribe the Manner in which such Acts, Records and Proceedings shall be proved, and the Effect thereof."

The framers intended that the Full Faith and Credit Clause, which establishes a rule of evidence rather than jurisdiction, close off an area of likely domestic cross-border friction, namely the full re-litigation out-of-state of matters that had been duly litigated to final judgment in-state.[46] It was all about trammeling the "runaway judgment debtor." The court of the sister state must defer to the rendering court's valid resolution of a matter, even if to do so would violate the public policy of the jurisdiction in which the court of the sister operates.[47] "[I]n other words, the judgment of the rendering State gains nationwide force."[48] Money judgments at law and in equity are particularly sacrosanct.[49] All the judgment creditor need do is submit to the court of the sister state a copy of the judgment along with a proper seal and attestation from the rendering court. Simple. This is the case even if the judgment is the product of a mistake of law.[50] There is a critical exception to this rule of judicial deference, namely if the procedures followed by the rendering court had violated the Due Process Clause of the Fourteenth Amendment.[51]

Nor does the Full Faith and Credit Clause mandate that sister states adopt the practices of judgment-rendering states regarding the time, manner, and mechanisms for enforcing judgments.[52] In other words,

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[45]William L. Reynolds, *The Story of the Full Faith and Credit Clause*, 41-DEC Md. B. J. 34 (2008).

[46]*See* Wisconsin v. Pelican Ins. Co., 127 U.S. 265 (1888) (Confirming that the Full Faith and Credit Clause establishes a rule of evidence rather than jurisdiction).

[47]*See* Baker v. Gen. Motors Corp., 522 U.S. 222 (1998).

[48]Baker v. Gen. Motors Corp., 522 U.S. 222 (1998).

[49]*See* Baker v. Gen. Motors Corp., 522 U.S. 222 (1998).

[50]*See* Fauntleroy v. Lum, 210 U.S. 230 (1908).

[51]*See generally* William L. Reynolds, *The Story of the Full Faith and Credit Clause*, 41-DEC Md. B. J. 34 (2008).

[52]*See* Baker v. Gen. Motors Corp., 522 U.S. 222 (1998).

enforcement measures do not "travel" out of state along with a judgment.[53] Accordingly, a judgement relating to out-of-state real estate may be ineffective to pass legal title, though effective in sorting out the rights, duties and obligations of the parties, assuming there is personal jurisdiction.[54] Thus there *may be* more than one constitutional way to skin the debtor cat in a multijurisdictional setting: "It may not be doubted that a court of equity in one State in a proper case could compel a defendant before it to convey property situated in another State."[55] In the case of the debtor-settlor-beneficiary of a domestic asset protection trust (DAPT), however, legal title to the underlying property *and the right/power to convey it* are not in the debtor-settlor-beneficiary but in the trustee.

A DAPT full-faith-and-credit practice tip. So let us return to the question we posited at the beginning of this sub-section: What if a debtor has established with all his property a trust in a DAPT state and the creditor owns a judgment against him that has emanated from the court of a non-DAPT sister state? Is the creditor entitled under the Full Faith and Credit Clause to have the judgment satisfied from the assets of the DAPT via a secondary action brought in the courts of the DAPT state? It would seem that it depends upon whether the action in the non-DAPT state had been a transitory one, in this case whether the DAPT had been funded via a fraudulent conveyance. If there is an out-of-state judgment to that effect, then the property ostensibly in the DAPT would be accessible to the settlor's out-of-state judgment creditors. Moreover, a unilateral effort by the legislature of the DAPT state to grant its courts exclusive jurisdiction over such out-of-state fraudulent-conveyance claims would not be entitled to respect under the Full Faith and Credit Clause.[56]

On the other hand, had the property lawfully found its way into the hands of the DAPT trustee, then, going forward, a judgment out of the DAPT jurisdiction that the property in the DAPT trust is unreachable by the settlor's creditors domestic and out-of-state, itself, would likely be entitled to the respect of the out-of-state courts by virtue of the Full Faith and Credit Clause.

Here is the practice tip: The debtor-friendly terms of a statutory DAPT are likely enforceable, provided (1) funding had not been via a fraudulent conveyance, (2) the settlor-debtor was and is a resident of the DAPT state, (3) the settlor-debtor is not subject to another state's personal jurisdiction, and (4) the Bankruptcy court is not in the picture. Otherwise, *caveat emptor*.

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[53]*See* Baker v. Gen. Motors Corp., 522 U.S. 222 (1998).
[54]*See* Baker v. Gen. Motors Corp., 522 U.S. 222 (1998).
[55]Robertson v. Howard, 229 U.S. 254 (1913).
[56]*See, e.g.*, Toni 1 Tr. v. Wacker, 413 P.3d 1199 (Alaska 2018).